B. Economic losses

451. The increasing frequency of natural catastrophes, coupled with an enhanced level of economic activities and geographic concentration of values in most countries of the world, has resulted in previously unseen losses. According to one estimate, 14 catastrophes occurred in the 1960s, each with an economic loss in the region of US$ 100 million. The number rose to 70 in the 1980s, which means an increase by a factor of five within three decades.[7] The continuous growth of the world population and its urbanization contribute to the ever-increasing economic consequences of natural catastrophes.

452. Two additional factors of consequence are population movements and industrial development. Recently populations have migrated to coastal regions which generally suffer a higher exposure to natural catastrophes. Industries have emerged in or have relocated to regions with higher exposure to catastrophic risks in search of new and cheaper resources.[8]

453. During the 1980s natural catastrophes represent the overwhelming majority of total catastrophes in all respects. Table 9 gives some indication of the proportions involved. It is important to note that, for the period of 1989-1992, the 10 worst losses each year, for both major loss and natural catastrophe, in terms of loss of life, were virtually all in developing countries. Similarly, if material damage is taken as a criteria, the years' 10 worst losses occurred exclusively in developed countries with the exception of Hurricane Hugo in 1989, which, besides the United States of America, affected the Caribbean as well.[9] This disproportion can be further illustrated by comparing the sum of events in North America, South America and Europe with the sum of events in Asia and Africa. In 1992, North America, South America and Europe accounted for 57 per cent of the natural catastrophe events, resulting in 8 per cent of the deaths, 83 per cent of the economic loss and a significant 98 per cent of the insured loss. In contrast, Africa and Asia accounted for 38 per cent of events, 92 per cent of the deaths, 16 per cent of the economic loss, but only 1.4 per cent of the insured loss.[10]

Table 9
Natural catastrophes and major losses, 1989-1992

Type of loss	Number of events				Insured damage				Number of victims			
	1989	1990	1991	1992	1989	1990	1991	1992	1989	1990	1991	1992
	in per cent				in per cent				in per cent			
Natural Catastrophe	28.1	35.9	33.7	40.1	61.8	82.5	77.0	83.0	50.2	88.2	85.5	54.3
Major losses*	71.9	64.1	66.3	59.9	38.2	17.5	33.0	17.0	49.8	11.8	14.2	45.7
	in number				in US dollars (millions)				in thousands (000)			
Total	292	298	320	323	13 281	17 029	14 085	27 141	15.5	69.4	182.8	24.4

Source: SIGMA, Swiss Re, 2/1990, 3/1991, 3/1992 and 3/1993.
* Major losses include: major fires, aviation, waterborne traffic, traffic, mine disasters, collapse of buildings/bridges and miscellaneous major losses.

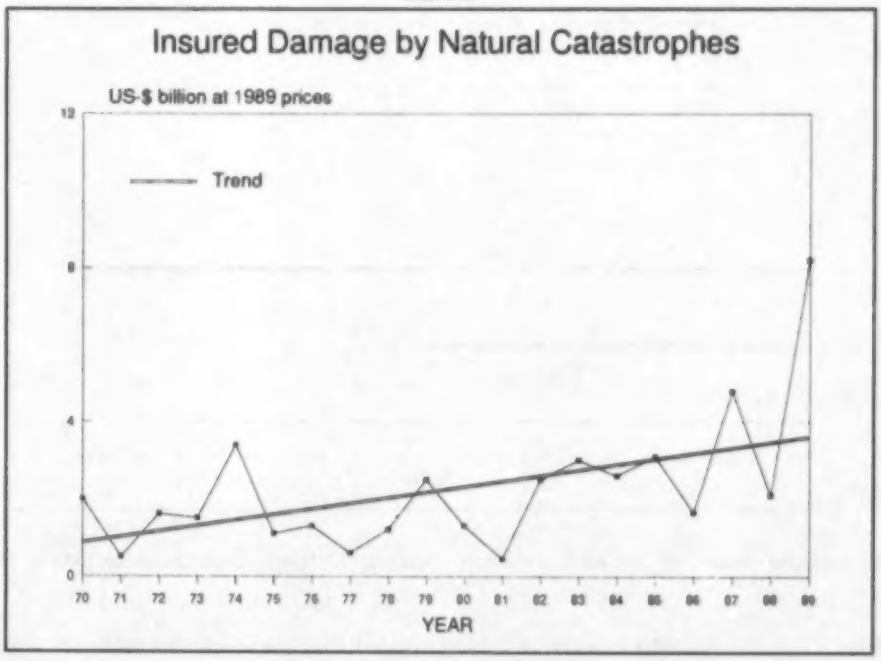
C. Insured losses

454. As pointed out, not all properties that are damaged and destroyed are insured. Assessments differ about the extent of insurance taken. According to one estimate, even in the highly earthquake-prone area of California, only 25 per cent of house owners and householders buy earthquake insurance.[11] Insurance penetration figures indicate that the extent of insurance in less catastrophe-prone areas and in less prosperous countries is only a fraction of this amount.

455. While today a greater number of people and properties are insured and are better insured than in the past, insurance is still far from being universal in its reach.[12] There are many reasons why properties susceptible to natural catastrophes are uninsured. Memories are short, and people tend to forget the widespread damage a catastrophe can cause. Many insureds are not well informed about the costs and probability of catastrophe to have developed a true perception of the premium rate. The insured's perspective is often that only a very nominal additional premium should be charged to include perils associated with catastrophe in normal property insurance. In the past many markets have insured the perils in question as an extension of the standard cover and as a result the insured perceives that such an event does not occur very often. On the other hand, insurers need to have adequate premium, not only to cover claims payments but to build a reserve for super-catastrophes. Catastrophe cover is often built into the total premium computation for industrial risks. Existing premiums for personal lines do not have sufficient loading to include catastrophe cover without additional charge. In addition, marketing problems often hinder rate increases for catastrophe extensions, as the sales organization often does not take sufficient interest in explaining and selling this additional cover.

456. Insurance companies in many developing countries are reluctant to enlarge their commitment to offer catastrophe cover. Few entities in developing countries which are exposed to catastrophic risks choose to have insurance. As a result, the spread is insufficient and insurers fear the consequence of an unfavourable selection of risks in their portfolio. Flooding is a natural peril which poses a clear selection problem for insurers in that policyholders in arid areas and distant from moving or still water, are usually not prepared to buy flood cover. Likewise, risks that are not on or near geological fault lines rarely carry earthquake insurance.[13]

Figure 4


Insured Damage by Natural Catastrophes
US-$ billion at 1989 prices
12
8
4
0
Trend
70 71 72 73 74 75 76 77 78 79 80 81 82 83 84 85 86 87 88 89
YEAR

Source: SIGMA, Swiss Re, 6/1990, p. 9.

457. Furthermore, accumulation poses a big problem for companies. Many of the companies writing fire and property insurance are small with a limited capital base. They wish to avoid exposing their net

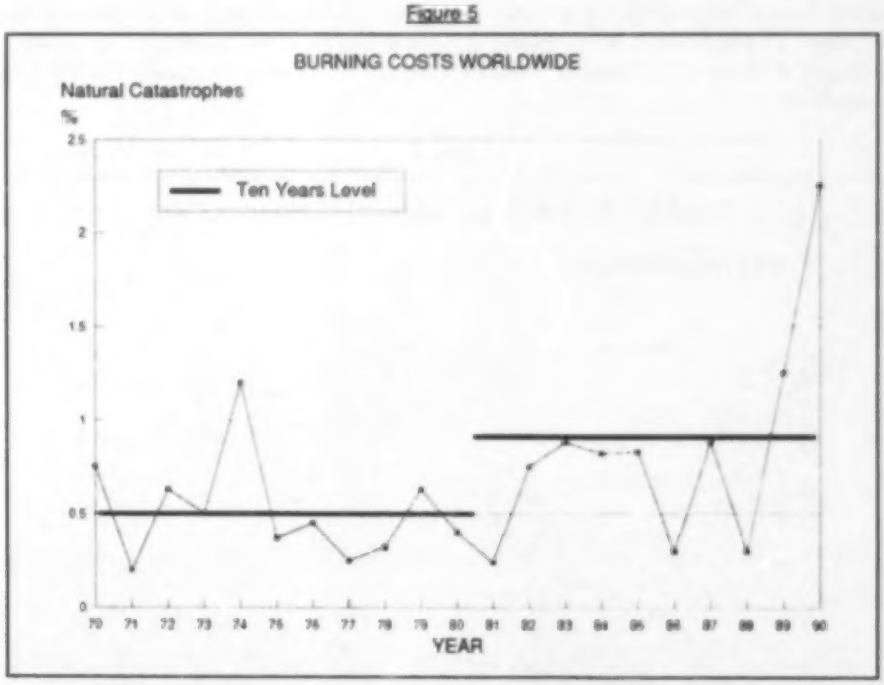
results to violent fluctuations. Since a catastrophe strikes only once in a while, savings or profits of a claims-free year have to be accumulated in a fund as reserves to meet liabilities when a loss occurs.

458. Tax authorities, however, are reluctant to allow such funding as tax deductible and insist on treating the catastrophe reserves from one year as profit in the usual manner. In Colombia, Mexico, Norway, New Zealand and Sweden, limited tax facilities are allowed for the creation of a fund to meet catastrophic losses.[14]

459. Despite the fact that the devastation caused by catastrophes is largely uninsured, catastrophes have still caused very high loss burdens to insurers in recent years (figure 4).

460. The proportion of insured losses accounted for by natural catastrophes increased in the 1980s in comparison with the 1970s. In the 1980s a new level was established at around 1.0 per cent of the world non-life premium income, which is twice the figure experienced in the 1970s. The peak years of 1989 and 1990 saw this proportion climbing to 1.5 and 2.3 per cent respectively and only three years in the 1980s were below the 0.5 per cent mark. Catastrophe claims in the 1970s oscillated around 0.5 per cent of world life premium income with a peak of 1.2 per cent in 1974 (figure 5).

Figure 5



Source: SIGMA, Swiss Re, March 1991, quoted by W. Jacobi, "Catastrophe", Reinsurance, December 1991, p. 16.

461. In terms of amounts, until recently it was estimated that the insurance industry must count on an average annual burden from natural catastrophes of about US$ 5 billion.[15] However, the figures have gone up further. In 1989 major catastrophe losses totalled US$ 9 billion, and in 1990 they approached the figure of US$ 11 billion.[16] The results in 1992 have deteriorated further, with insured losses from hurricane "Andrew" that hit the states of Florida and Louisiana in the United States of America.

D. Reinsurance and natural catastrophes

462. Without the support of reinsurers, insurance companies would find it difficult to face the large losses caused by catastrophic events. In fact, reinsurers have shared a substantial part of the losses caused by natural catastrophes. In the earthquake in Mexico City, in 1985, reinsurers shouldered 97 per cent of the losses. The situation was much the same in the aftermath of hurricane "Gilbert" in Jamaica in 1988 and of hurricane "Hugo" in Puerto Rico in 1989.[17] Reports on the earthquake of 13 March 1992 in Erzincan, Turkey, observe that a major portion of the national reinsurer's earthquake exposure is ceded in London and continental European markets.[18]

463. The reinsurance market for catastrophic risks is not very large and keeps fluctuating. The single largest catastrophe reinsurance placement is believed to be the New Zealand earthquake programme of approximately US$ 570 million.[19] The recent catastrophic losses have resulted in a significant loss of capacity in the retrocession market. The market began shrinking as early as 1987, continued to do so in 1988 and 1989 and faced a crisis in 1990.[20] In 1993 capacity in the London retrocession or "spiral" market collapsed but some catastrophe capacity has been restored in London for 1994.[21]

464. The international reinsurance market has been unprofitable in recent years, and catastrophe losses are largely held responsible. The top 100 companies showed a combined ratio of 111 per cent for 1989, as compared to 108 per cent in 1988. A combined ratio of 115 to 120 per cent is estimated for 1990. In the United States of America, combined ratios for all reinsurers developed from 103 to 107 to 106 per cent respectively during 1988, 1989 and 1990.[22]

E. Measures to augment natural catastrophe reinsurance

465 Insurance companies are seeking protection to a greater extent than in earlier periods. However, the reinsurance market has hardened, although the conditions required by reinsurers differ from market to market, depending upon its proneness to catastrophic losses, limits of cover sought and past experiences.[23] The following are some of the important measures which have been suggested.

a. Much greater information than in the past; a very detailed London Market Questionnaire has been conceived to this end. In particular, the transparency of exposures has to be ensured. This will enable reinsurers to adjust their available capacity to the needs of the market and avoid the superfluous commitment of capacity. Within CRESTA (an organization of insurers, reinsurers, brokers and risk managers founded in 1977), the topics of windstorm and flood exposures have gained momentum. A set of returns has been developed for various countries in order to monitor the aggregates from natural perils per postal zone or even smaller regions in the case of flood covers. A loss report has also been developed which shows actual losses against sums insured for buildings, contents and loss of profit. This enables more accurate assessment of PML (Probable Maximum Loss) and burning costs per region.[24]

b. Efforts should be made to market catastrophe risks in new areas and regions, particularly those that are apparently not exposed, or where the return period is long; a better spread will go a long way in alleviating the problems of both insurance companies and reinsurers and will counteract adverse selection.

c. Long-term contracts should include the right to review rates.

d. Claims handling efficiency should be improved; claims from a natural catastrophe all arrive at the same time, and there is social or government pressure to expedite a large number of claims so that the rehabilitation and reconstruction process can be speeded up.

Under these circumstances the surveyors and loss assessors cannot go through the process of detailed scrutiny. Markets, therefore, have to evolve guidelines in advance for processing such claims. In particular, a tendency to include earlier minor damages and lack of maintenance in a claim arising from a catastrophe has to be guarded against (for example, cracks in a building which have developed over the years as part of wear and tear and aging, are often attributed to earthquake damage).

e. Wordings should be as precise as possible, for example what constitutes a windstorm or what kind of accumulation of water is to be regarded as a flood.

f. The imposition of co-insurance by the insured and judicious introduction of deductibles and franchises are recommended. In extreme cases, certain hazards may be excluded altogether.

g. Restricting indemnity; the case of Japan is cited in this connection, where limits both in terms of maximum amounts and percentage of sum insured are observed.[25]

h. Premium rates can be increased for risks deemed catastrophic in nature in a specific region, for example increased earthquake rates in earthquake-prone areas or increased windstorm and related perils rates in areas which are susceptible to these events.

i. Separation of premium charged for natural perils from the main cover. Although this has not been common in many markets, it will allow insurers to judge the adequacy of the premium, and will enable proper statistics to be compiled;

j. Increasing reinsurance rates, which in the case of excess of loss arrangements (catastrophe risks are usually protected by such non-proportional reinsurance) are not based on the rates charged to insurers, but are applied to the total premium of the company in that line of business. It has been stated that "catastrophe reinsurance as a product has been underpriced for many years....",[26]

k. Limiting the reinsurers' liabilities. In Excess of Loss arrangements this is set by the event limit. In proportional reinsurance, on the other hand, the reinsurer is liable (up to a defined extent) on all policies issued by the insurer and some reinsurers are therefore imposing a cession limit. This may indirectly imply limiting the number of policies or the amounts which an insurance company can write against natural perils.

l. The adoption of risk management practices and loss prevention and containment systems; while natural catastrophes are unavoidable, there is still insufficient awareness, particularly in developing countries, that losses due to such events can be managed and reduced through physical measures to minimize risks. While the specific action goes beyond the activities of the insurance sector, it is advisable that a strong message be projected to the public and governments, and a "lobby" be created for improvement of building codes, coastal and flood defences and cities' drainage systems.

466. The programme set forth by the United Nations in connection with the International Decade for Natural Disaster Reduction includes:

- The mapping of hazard zones;

- The assessment of loss potentials resulting from different catastrophe scenarios;

- Land-use regulations/restrictions;
- Standardization of building codes;
- Standardization of loss information;
- Development of forecast and warning services;
- The improvement of public information, awareness, and motivation.[27]

467. The Reinsurance Committee of the Insurance Association of the Caribbean produced a report, in 1993, that addresses the effects of changes in the international catastrophe reinsurance market. Proposals to ease the situation of home owners and private and public sector business include the establishment of a data bank, adherence to a uniform building code, mechanisms for rating of insurance companies and the implementation of a Hazard Mapping Concept.[28]

F. Implications of suggestions made

468. Many of the preceding suggestions should allow for regional and country variations in implementation. Some of the ideas are too costly to be implemented in totality, for others the process can only be gradual and adoption of suitable measures will take time.

469. Losses from natural catastrophes have become a focus of concern for the insurance and reinsurance sector. Two points made in this connection, despite their limitations, have a certain justification. First, although complete supporting global statistics of premium income generated and losses incurred are not available, the data that are available indicate that OECD countries insure far more of their property against catastrophic losses than other parts of the world. According to an estimate, 78 per cent of total insured damage from catastrophes was recorded in these countries.[29] Secondly, although large losses have been faced, the reinsurance world has been able to withstand the shocks. While combined ratios often surpass the 100 per cent level, substantial investment income allows insurance operations to continue.

470. The increase of insured catastrophic losses in recent years has made it necessary for reinsurers to harden the terms for catastrophe reinsurance and has encouraged them to diversify their portfolios by extending business into regions less susceptible to natural catastrophe. The rate increases and the restructuring by the international reinsurers has provoked the disapproval of several developing countries. The Governments of Trinidad and Tobago, Jamaica and the Bahamas assert that the recent rate hikes have made it impossible for local insurers to afford excess of loss cover and that few reinsurers are prepared to do business in this area, while those that still do strictly limit the amount of business they write.[30] It is reported that rates in the Bahamas have "...increased between 100 and 300 per cent after Hurricane Andrew caused an estimated US dollars 58 million insured losses."[31] Still, the major global reinsurers are advising the international market to limit catastrophe commitments and to push for rates that reflect the expected loss trends if "... premiums direct insurers charge their policyholders are not yet commensurate with the risk."[32] In the Philippines, it was reported that the major international reinsurers have "extended the natural perils coverage of the proportional reinsurance treaties of Philippine non-life insurance companies up to 31 March 1994 subject to sharply increased premium rate."[33] The planned increases are deemed quite large by insurance buyers. The proposed rates are more than double for earthquake, five times for typhoon, while the increase for flood cover is almost ten-fold for certain locations. Many local insurers are concerned that the international market is unfairly penalizing them for huge losses incurred in North America and Europe in recent years.

471. A distinction can be made here between markets and regions that are exposed to natural catastrophes and have had substantial insured losses, and those that are better situated. From the point of view of the first category of markets, a hardening of reinsurance terms can be expected which will strain the capacities of regional insurers and may lead to a reduction of whatever natural catastrophic cover they are able to offer.

472. Markets that experience catastrophes less frequently, when faced with the hardening of reinsurance terms for catastrophic risk, may take advantage of the new competitive situation to the extent that they can retain more risk themselves, or may find their business more sought after by reinsurers attempting to diversify their portfolios.

473. Given the regional disequilibrium of insured catastrophic losses and the possible hardening of reinsurance terms, there is a danger that many developing countries may be increasingly unable to afford the level of cover they need. On the one hand, it is true that, generally speaking, premium rates charged for catastrophe risks in many developing countries have been too low. Further, in the international reinsurance market a narrow country or regional view is not always appropriate. It is in the very nature of insurance and reinsurance that, during periods when no catastrophe occurs in a given country, premiums arising from that country are needed to pay catastrophe claims in other regions. On the other hand, the extra revenues from making insurance and reinsurance of catastrophe risks in developing countries indiscriminately costlier still adds little to world receipts of catastrophe premiums, since they still buy little catastrophe cover.

G. New offshore catastrophe reinsurance capacity

474. In 1993, new catastrophe reinsurance companies have been formed in Bermuda in response to the improvement in rates and conditions for catastrophe cover. However, the new capacity has publicly stated that it will not compete by rate cutting and thus reverse the trend for rate increases, although the presence of the new capacity may result in lower prices. The new facilities are typically being capitalized by the large international reinsurers combined with United States investment houses.[34]

475. It has been reported that only 15 to 20 per cent of the new Bermuda catastrophe capacity relies on capital injected by international reinsurers. The majority of the capital has been provided from the financial markets and, similarly to the investment funds entering Lloyd's as corporate entities, is looking for returns of around 20 per cent. Some commentators are of the opinion that such a performance cannot be achieved without writing "...a great deal of first-layer business..."[35] and, thus, a large number of small losses cannot be avoided. A case in point is the establishment of Partner Reinsurance. The company will be eventually capitalized at US$ 755 million of which only 100 million is provided by Swiss Re which will provide the technical expertise for the venture. The reinsurer does not intend to take a stake of more than 20 per cent as this would oblige it to consolidate Partner Re's position into its own accounts.[36]

H. Catastrophe reinsurers in developing countries

476. Typically reinsurance companies in developing countries have a modest capitalization, and while they have to play a role in reinsuring natural catastrophe risks of the region within the capacity available to them, it is beyond their scope to venture into international catastrophe reinsurance business. This explains the need for international reinsurance in this line of business.

I. Role of the State

477. In developing countries the involvement of the State is inescapable when a catastrophe occurs. It has been argued that commercial insurance mechanisms, meant primarily for relatively frequent small losses, have severe limitations in effectively relating to catastrophic losses.

478. Insurance can only cover damage to risks that have been insured. Insured damage is often only a fraction of the economic damage and governments, even in advanced market economies, have felt obliged to provide direct compensation for insured and uninsured losses from natural disasters. Losses caused by major catastrophes can reach such tremendous amounts that it is doubtful whether the whole world insurance sector together is strong enough to absorb the totality of the risks.[37] In fact, with the possibility of a further rise in catastrophic losses and the hardening of the reinsurance market, the contribution the local insurance sector can make may, if anything, diminish.

J. Interface between insurance and government relief

479. The insurance sector and the government department in charge of catastrophe relief programmes should fully explore possibilities for mutual cooperation. Attention should be paid to areas of overlap and to where a commercialization of existing public security mechanisms may bring greater financial discipline and accountability.

480. In Israel, according to the Law for the Compensation of Those Hurt by Natural Disaster, the sum that has been or will be paid as per the insurance cover will be deducted from the government relief scheme.

481. In the Islamic Republic of Iran, the Relief Fund for Damaged Agricultural Units, which provides catastrophic aid to affected farmers, excludes products and perils covered through the Agricultural Products Insurance Fund.

482. In France, only farmers who have taken basic cover are entitled to receive aid from the National Guarantee Fund for Agricultural Calamities. The Fund is financed by the Government and the compensation varies from between 25 and 28 per cent, if the farmer has fire and allied perils insurance on his buildings and premises, to 35 per cent if he has hail insurance on his crops. The application for compensation has to be routed through the farmer's commercial insurer and thereby requires him to purchase available commercial cover. Such a policy stimulates the spread of insurance.

483. In the United States of America, a Federal Earthquake Insurance and Reinsurance Corporation Act has been proposed which would provide for the creation of a federal earthquake insurance programme. The Project addresses the issue of the uninsurability of earthquake and volcanic eruption exposure and consists of two elements: (1) a primary residential property insurance programme, and (2) an excess reinsurance programme. Owners of residential property would not be allowed to receive government disaster relief if they did not purchase the cover. All premiums would be tax exempt and the residential property insurance would be obligatory for all owners with mortgages backed or reinsured by a federal agency or issued by a federally insured institution.[38]

484. The schemes mentioned above may provide valuable guidance for Governments considering the introduction of catastrophe relief measures in developing countries.

Notes

1. SIGMA, Swiss Re, 6/1990, p. 29.

2. David Thompson, President, North American Reinsurance Corporation, quoted in Business Insurance, 2 November 1992, p. 30.

3. Franklin Montross, Senior Vice-President, General Reinsurance Corporation, The Review, April 1993, p. 30.

4. Business Insurance, 30 October 1992, p. 145.

5. World Insurance Report, No. 434, 10 April 1992, p. 8; SIGMA, Swiss Re, 3/1992, pp. 26-32.

6. Sigma, Swiss Re, 3/1992, p. 48.

7. Koye, B., "Catastrophic risk insurance", presented at the 8th TWIC, New Delhi, February 1992.

8. Ibid.

9. Sigma, Swiss Re, 2/1990, 3/1991, 3/1992 and 3/1993.

10. Schadenspiegel, Munich Re, No. 1, 1993, pp. 16-18.

11. Palm, R., "Earthquake insurance: Some findings from home owner study", Institute of Behavioral Sciences, University of Colorado, Boulder, 1990.

12. Munkhammar A. and Themptander R., "Catastrophe insurance", The Geneva Papers on Risk and Insurance, No. 31, April 1984.

13. Assurer, No. 9, 15 February 1993, p. 3.

14. Ibid.

15. Koye, op. cit.

16. Greig, John S., "The effects of the recent world catastrophes on reinsurance capacity - A broker's perspective", presented at the 1st Singapore International Reinsurance Conference, Singapore, 6-9 October 1991.

17. Koye, op. cit.

18. Business Insurance, 23 March 1992, p. 86.

19. Greig, op. cit.

20. The Review, April 1992, p. 19.

21. Greig, op. cit.

22. Reinsurance, January 1992, p. 21.

23. A separate UNCTAD study, "Alternatives for the insurance of catastrophes, environmental impairment and large risks in developing countries" (UNCTAD/SDD/INS/7), deals with the particular problems that developing country insurers and reinsurers have in securing catastrophe reinsurance in the dynamic international market.

24. Reinsurance, January 1992, p. 12.

25. Morimiya, Y., "Demand for natural disaster insurance", The Geneva Papers on Risk and Insurance, No. 31, April 1984, pp. 277-278.

26. Greig, op. cit.

27. Koye, op. cit.

28. Insurance Research Letter, September 1993.

29. SIGMA, Swiss Re, 6/1990, p. 14.

30. The Review, March 1993, p. 5.

31. World Insurance Report, No. 465, 2 July 1993, p. 5.

32. Munich Re, as quoted in Reinsurance Market Report, 4 May 1993, p. 4.

33. Asia Insurance Review, January-February 1994, p. 14.

34. Business Insurance, 21 June 1993, pp. 1 and 54.

35. Christian Escoffier, President-Director General, AXA Réassurance, as paraphrased in World Insurance Report, No. 470, 10 September 1993, p. 1.

36. Richard Lieberman, Swiss Re, as paraphrased in Reinsurance Market Report, 8 September 1993, pp. 1-2.

37. Munkhammar and Themptander, op. cit.

38. CPCU Journal, March 1992, pp. 49-54.

Chapter X

REINSURANCE

A. International reinsurance markets

Introduction

485. During the period under review, the problems of developing countries in the sphere of reinsurance were, to some extent, a reflection and a consequence of losses which reinsurance companies continued to incur, in both developing and developed countries.

Underwriting performance

486. Table 10 shows the operating results of some reinsurers. The unprofitability of operations in the last few years of many syndicates of Lloyd's of London, which remains an important reinsurance market, has received wide publicity. Losses amounted to US$ 4.8 billion in 1990, the largest in the 304-year history of the institution. This came on top of a loss of US$ 3.85 billion in 1989, while a loss of US$ 5.0 billion is expected for 1991 (preliminary estimate). A total of US$ 13.5 billion in losses is expected for the underwriting years from 1988 through 1991.[1]

Table 10
Underwriting and operating results of selected professional reinsurers

Company	(year)	Underwriting results as a % of net premium	Investment income as a % of net premium	Pre-tax operating profits
Egypt Re	(1991)	-20.96	22.38	+
Munich Re	(1991)	-11.52	19.13	+
Swiss Re	(1990)	-8.64	15.82	+
Royal Re	(1990)	-25.00	10.36	-
Singapore Re	(1990)	-9.00	20.25	+
Malaysia Nat	(1991)	-2.60	18.36	+
Cigna Re	(1991)	-6.10	13.21	+
Korean Re	(1991)	-16.00	13.50	-
ARIG Re	(1991)	-44.16	32.60	-
ASIAN Re	(1990)	-15.50	16.98	+

Source: Asian Reinsurance Corporation, Bangkok.

487. Several factors contributed to the underwriting losses of international reinsurance business. First, the major direct insurance markets of the world continued to produce underwriting losses and this is reflected in the underwriting results of reinsurers. The United States of America, Canada, Japan, Germany, France, Italy, the Netherlands and Switzerland accounted for some 80 per cent of worldwide non-life premium income. These markets, with the exception of Germany, all produced underwriting losses over a long period (see table 11). Secondly, with the emergence of a greater number of large risks, the share of medium and small risks has decreased, thus changing the composition of insurance portfolios. Thirdly, a non-proportional basis for reinsurance has been adopted by a number of companies in different markets. The results of this form of reinsurance tend to be more volatile.[2] Fourthly, the erosion of rates

in primary markets, due to ongoing deregulation, has put a downward pressure on reinsurance rates.[3] Finally, catastrophic losses, both natural and man-made, are increasing.[4]

Table 11
Underwriting results as a percentage of premiums
(Average over the period 1975-1989)

Country	Result in per cent
United States of America	- 7.5
Canada	- 6.8
Japan	- 0.5
Germany	+ 0.8
France	- 11.0
Italy	- 10.8
Netherlands	- 3.9
Switzerland	- 8.2

Source: SIGMA, Swiss Re, 6/91, pp. 3 and 22-26.

Investment income and profitability

488. Underwriting losses do not always imply unprofitability in overall operations. Most insurance and reinsurance companies have a sizeable investment income, arising from both free and technical reserves, which are funds held for pending liabilities, and current cash flow. Table 12 shows the pre-tax return on equity of the non-life sector. Nevertheless, a reinsurer does not participate in the investment income of the ceding company and is concerned only with the underwriting results of the reinsured business.

Table 12

Continent	Pre-tax return on equity	
	1987 (in per cent)	1990 (in per cent)
Asia	18.6	14.1
Europe	8.9	8.3
North America	13.4	8.2
Aggregate	10.9	8.5

Source: Alan Levin, "Reinsurance market report", 14 July 1992, p. 13.

Condition of the market

489. While specific conditions within the market differ from one class of business to another, generally "soft" conditions prevailed up to the end of 1991. Over-capacity has been one of the reasons. However, some hardening of the market is occurring. It has been reported that, due to continuing overall losses of recent years, "rates were hardening, sizes of deductibles were back to healthier levels and there was a more prudent approach to the acceptance of risks."[5] It is probable that the present level of rate increases will continue and possibly accelerate in the near future.

490. The soft market conditions have affected developing countries as both buyers and sellers of reinsurance. On the whole, it was possible to place reinsurance without much difficulty and on relatively

advantageous terms. Under hardening market conditions, developing countries as buyers of reinsurance are experiencing a situation where terms of reinsurance have gone up substantially, or are likely to go up steeply, the result being that some covers are not being fully placed.

491. As sellers of reinsurance, on the other hand, soft conditions did not help reinsurers of developing countries to expand their business. Nor could the full benefits of the hardening market be obtained by some reinsurers from developing countries, since they were unable to meet standards of security required by international markets. As a result, many have found themselves further marginalized. Various aspects of reinsurance of developing countries, as buyers and sellers, are discussed below.

B. Developing countries as buyers of reinsurance

Introduction

492. Although developing countries do not account for a major share of global insurance transactions, relative to their internal market size, demand for international reinsurance remains high. There are several reasons for this. Often there is a "structural imbalance" between volume of premiums of a given class of business and liabilities reinsured per risk, or even by accumulation.[6] This necessitates substantial reinsurance. Further, a high rate of inflation, a phenomenon prevalent in many developing countries, means an erosion of real retention capabilities. Retentions are fixed in terms of nominal monetary amounts and not revised pari passu with the rate of inflation. The most important reason why insurance companies rely heavily on reinsurance is that their capital is small and their reserves are low, leading to modest capacity and low retentions. Insurance companies cannot afford to retain more of their own risks without lowering their solvency margins to levels that would impede their security. In spite of the use of sophisticated models, it is difficult to assess future variance of loss experience.

493. Furthermore, the capital base of insurance companies in developing countries is often not sufficient to provide substantial investment income as a cushion against severe claims fluctuations. Therefore, they have to be very cautious not to incur underwriting losses. The imposition by governments of compulsory investment requirements and investment restrictions may seriously curtail investment earnings. China Re and Singapore Re have reported a decline in investment earnings for 1992 as a result of lower interest rates. Both reinsurers have the bulk of their investments in relatively secure bank deposits rather than in equities.[7]

Risk assessment and PML underwriting

494. Often, an imbalance exists between the high sophistication of many large risks and the technical know-how available locally, leading to their heavy reinsurance. To determine the extent of reinsurance required for a risk, it is necessary to adopt the PML (Probable Maximum Loss) underwriting principle. It is based on the consideration that a risk is not likely to be totally destroyed by occurrence of a peril. If it can be determined that the total possible and renumerable damage is only one third of the full exposure, three times the amount can be retained in monetary terms. An erroneous determination of PML leads to inappropriate reinsurance. If the PML is fixed on the high side, the amount retained by an insurer will be comparatively low and a higher extent of reinsurance will be sought. Conversely, a low PML exposes the net account of the company.

495. The proper determination of the PML requires a high level of expertise and experience. This is generally lacking in developing countries. In some countries, for example in India, insurance companies have a large cadre of qualified engineers employed to assess their own PML. In other countries, the concerned international reinsurer, or the broker on his behalf, arranges an inspection and determination of the PML. This works satisfactorily, but means that expertise is not built up in the local market. Often,

the PML concept is not utilized at all. A gradual development of expertise to determine PML would help decisively to increase the retention of many insurance markets.

Reinsurance placements and markets

496. Reinsurance placements can be grouped into proportional and non-proportional treaties and facultative reinsurance. Proportional basis is the traditional method of reinsurance. A large number of insurance companies in developing countries have proportional reinsurance as the base of their arrangements. The main advantage is that this provides a small insurance company with the ability to accept larger values of risk than it could write for its own account and that the arrangement is easy to operate, requiring only a simple multiple calculation. However, proportional reinsurance often "imposes for the insurer an obligation to cede more business than strictly desired and it does not necessarily provide an absolute limit to the ceding companies' exposure in the event of a loss".[8] Facultative reinsurance is sought for large individual risks with high exposures and insufficient spreads. When a company grows in size and attains financial strength, it may increase its retention. A programme of non-proportional reinsurance in the form of an annual excess of loss treaty, an excess of loss for protection of the net retained amounts, or for catastrophe exposures may then be sought to protect against large losses or accumulations of smaller losses.

497. A general classification of the markets where the above categories of reinsurance can be placed is helpful to understand the problems of developing countries, although in actual practice the boundaries are not always clear and often overlap. Proportional reinsurance on major lines of fire, accident and marine business can be exchanged on a reciprocal basis - matching in premium and in profitability over a period - with other insurance companies, either through brokers or contacts established directly. However, reciprocal exchange requires a well-balanced treaty and reasonably stable results. The United Kingdom insurance sector has almost gone out of this market[9] while some European insurers are still able to maintain a reciprocal trading relationship. Japan, with its profitable results on direct business, is an important trading market for reciprocal business with many countries.

498. Non-proportional stop loss or excess of loss covers are sought for protecting the net account, for large risks or for accumulation against catastrophe exposure. Business relating to natural catastrophe perils, such as earthquakes, is usually placed on a non-reciprocal basis in the international reinsurance market.

499. Facultative reinsurance has the advantage that the specific risks and the respective rates are known to the insurers. Facultative business emanating from developing countries is generally profitable. It is true that the capacity of reinsurers in developing countries in accepting large facultative lines is limited, and the direct writing company may prefer to entrust the placement to a reinsurer who can provide sufficient capacity. However, it should be possible to find a workable solution to this difficulty, where the reinsurance company may play the role of intermediary for international placement of large facultative lines. National and regional reinsurers should play an active role in this area.

500. Both Africa Re and Asian Re are developing acceptance of facultative business from their region. Singapore Re reported that its 7 per cent premium income growth in 1992 was mainly attributable to facultative business.[10] International reinsurers also seek out this business. While reciprocity cannot always be expected, often informal arrangements are made whereby the recipient would give some business in return.

Problems of reinsurance placements by developing countries

501. Some difficulties with reinsurance placements of developing countries can be noted. International reinsurance is sought mostly on fire (and allied perils), marine and aviation risks. Although the direct

premium rates on property risks are generally good, in a number of countries the liberalization of insurance markets has led to an erosion of premium rates. Concurrently, many of the property risks in the industrial sector and the marine fleets of developing countries are aging and often poorly maintained, as a result becoming "heavier risks" year by year.[11]

502. International insurers draw attention to the common practice whereby ceding companies in developing countries pay them less interest on deposits held than the deposits actually earn. Most importantly, there is often an unreasonable delay in settlement of balances due to reinsurers, sometimes because of inefficient management procedures and in other cases as a result of foreign exchange problems of the country. In many countries, official procedures have been introduced for remittances, and often these are time consuming. Governments, faced with a shortage of hard currency, are obliged to determine priorities for its allocation and reinsurance payments are often low on such lists. Delays in settlement of balances and the possibility of devaluation in the intervening period can influence reinsurance rates and available capacity.[12]

503. The authorities responsible for releasing foreign exchange for reinsurance placements have to realize that, in the medium to long term, payment of premium due to reinsurers does not represent an outflow of foreign exchange. The definitive drain of foreign exchange is represented by the net balance after adjustment for commissions and claims received. A timely remittance of premiums due to reinsurers may minimize costs invoked by delayed payments and will promote the efficient reimbursement of claims, while at the same time securing good terms and conditions from the reinsurers as well as the availability of proper capacity.

Fronting arrangements

504. Fronting is a practice followed by some companies in developing countries. In this case, the insurer prefers to act as a risk-broker rather than a risk-taker and retains minimally and reinsures the bulk, thereby earning a secure commission. Such a practice is also followed by those who have withdrawn from the market as direct insurers but continue to operate by broking business for reinsurers.[13] If commissions earned are used to capitalize the insurer, fronting may be seen as conducive to increasing capacity and retention. It must not be seen as a replacement for developing viable insurance operations and building up expertise. With the growth of the insurer, the proportion of fronted business should relatively decrease in favour of business written for its own account.

Retention capacity

505. An analysis of statistics compiled by the UNCTAD secretariat on insurance and reinsurance in developing countries (see figure 6) reveals the position of retained premium before and after receipt of inward reinsurance. Out of a sample of 87 countries, retention before inward reinsurance was below 30 per cent in 9 per cent of countries. When inward reinsurance was accounted for, the number of countries in this category fell to 3 per cent. At the other end of the spectrum, the number of countries that retained more than 90 per cent improved only marginally from 5 per cent to 6 per cent, before and after inward reinsurance respectively. The most significant variation was in the aggregate group of countries that retained more than 70 per cent (shadow area in figure 6). This category of countries increased from 23 per cent before inward reinsurance to 34 per cent after inward reinsurance.

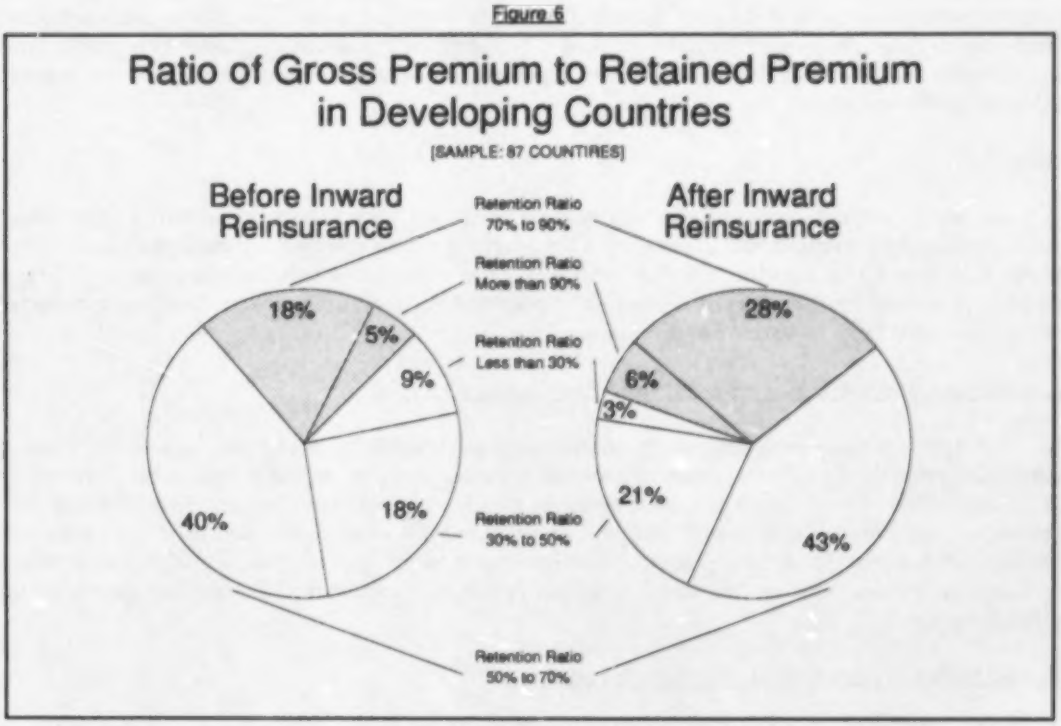
506. Improving the retention capacity of national insurance markets has traditionally been a major goal of developing countries. Among other measures this would require a restructuring of markets. If financially stronger companies could emerge either as a consequence of mergers and acquisitions or through improving the capital and solvency margin requirements of insurance companies by way of government policy, the retention and capacity of markets would improve. A large number of undercapitalized companies usually require more reinsurance and are an important cause for the low

retention capacity of many markets. In contrast, a smaller number of companies with ample capital would lead to higher retention.

507. Possibilities exist for increasing retentions selectively and adjusting them between various risks. For this purpose, portfolios will have to be examined to ascertain which risks can be retained without exposing the net account of the company. This would require both an adequate statistical basis and a good technical knowledge of underwriting.

508. Another aspect which needs to be taken into account is the matching of currency which would be required for the reinstatement of damages. Generally speaking, for risks whose repair or replacement does not require imported goods or services, a higher amount of reinsurance may be taken out. On the other hand, the reinsurance of marine cargo and hull, aviation and high-technology plants in the international market can provide hard currency for restitution if local conditions do not allow insurers to match the currencies of invested resources to risks.

Figure 6



Source: Statistical Survey on Insurance and Reinsurance in Developing Countries 1984-1986 (UNCTAD TD/B/C.3/231).

Reinsurance security

509. Security of reinsurers has assumed great importance in recent times, as insurers have not always been able to collect claims and other awards from their reinsurers. This has been due either to the failure of some reinsurers, or to disputes between the ceding company and the reinsurer over some technical or legalistic aspects of the contract. As far as the financial viability of reinsurers is concerned, there is no substitute for proper checking. Reinsurance brokers have strengthened their security departments, and many maintain lists of reinsurers of acceptable security for placing business on behalf of their client insurance companies. Nevertheless, the ceding company has to remain vigilant about the security of its

reinsurers, since the analysis made by the broker is only a service and ultimately may not always engage his responsibility. Services offered by specialized institutions which produce security analyses of insurance and reinsurance companies on a worldwide basis are available and should be better utilized. The growing concern with the security of reinsurers has favoured the prominent international reinsurers whose financial stability is considered to be beyond doubt.

510. The quality of the business offered for reinsurance and the terms of reinsurance sought determine the security that can be obtained. If the business to be reinsured is of inferior quality and a very cheap rate is sought, the security is likely to be inferior.

Early receipt of dues from reinsurers

511. Quick receipt of reinsurance claims is of prime importance to insurers in developing countries as they may not be in a position to finance claim payments to direct clients. The London market has usually taken an accommodating view in interpretation of reinsurance contracts for the swift payment of claims. European reinsurers also enjoy a commendable record of willingness and speed as regards settlement of claims. Lately, though, a more formal approach is being taken in various markets. This puts a strain on the insurance sector of developing countries, especially since the wording of reinsurance contracts is proposed by the reinsurer.

Continuity

512. In order to obtain competitive terms, various reinsurers have to be approached. At the same time, continuity is an important aspect in building a long-term business relationship between insurers, brokers and reinsurers and is a significant factor influencing the terms on which the reinsurer is willing to do business. It would be necessary to identify the potential for continuity when choosing a reinsurer, as common interests help to surmount difficulties.

Attractiveness of reinsurance business from developing countries

513. In spite of many weaknesses in the reinsurance placed by developing countries, their direct business is generally regarded as profitable and its reinsurance is, therefore, sought after. One reason for this is that many direct insurance companies in developing countries benefit from monopolistic or oligopolistic conditions, i.e. a lack of competition and/or high-level tariffs. On their part, international reinsurers endeavour to diversify their commitments beyond the reinsurance business available in developed countries, which often has a long-tail and heavy exposure. Developing countries offer a workable option.

Effect of hardening markets on developing countries

514. However, the recent hardening of the international reinsurance markets is causing some concern to buyers of reinsurance in developing countries. It is feared that reinsurance terms for their risks will be increased due to overall underwriting losses in the international market. It has been reported that this has in fact happened in some classes of oil and energy business, where the terms have been affected by losses incurred by reinsurers in other geographical areas. Experience tends to show that when there is a trend towards upward revision of terms and conditions, the burden falls less heavily on major markets, since reinsurers try to avoid alienating them. The major markets incur smaller marketing and administrative costs as a proportion of total premiums and important accounts may be maintained for cash-flow considerations. In this respect smaller markets are more vulnerable and suffer more.[14]

Importance of international reinsurance markets for developing countries

515. London has traditionally been the centre of international reinsurance. However, the problems of Lloyd's have meant some setbacks. The number of syndicates diminished from 354 in 1991 to 275 in 1992, and it is believed that it may go down further in 1993.[15] Nevertheless, Lloyd's continues to be important both for capacity and for providing a "lead". The opening of the London Underwriting Centre (LUC) is expected to strengthen the London market considerably. Professional reinsurers from continental Europe have the largest share of the LUC market and have been gaining in importance. They support reinsurance programmes of many developing countries and also play a significant role in providing technical assistance and training. It is widely acknowledged that reinsurers play a vital and significant role in the development of domestic markets of developing countries. When the risk is not of such a high exposure that reinsurance in a widespread market is unavoidable, a requirement is sometimes imposed by reinsurers in both London and continental Europe that the major portion of reinsurance be placed with them. Reinsurers justify this on the grounds that fixed costs, in a cession of decreasing size, increase to the point were the prevalent market rates cannot be maintained. From the point of view of buyers of reinsurance in developing countries, this restricts their options and the development of contacts with a more varied market and directs them towards international brokers.

516. The reinsurance market of the United States of America has not played a significant role in developing countries in Asia and Africa, in spite of its size and the sophistication of its institutions. One reason advanced for this is the entrenchment of a very detailed formalistic and contractual system of reinsurance in the United States of America. There is, however, a growing awareness of the issue and a desire on the part of American reinsurers to enter the markets, and offices have recently been established in Hong Kong and Singapore for developing reinsurance business in the region. Reinsurers from the United States of America are quite active in many Latin American countries.

Mechanism of reinsurance placements

517. The mechanism of reinsurance placements in the international market has been specified in many developing countries, usually by the respective supervisory authorities. In some countries, all reinsurance has to be channelled through the national reinsurance company. This has been the case in Brazil, Uruguay and Algeria. It was considered that dealing with international markets requires special skills, and the interests of the market would be best served by consolidating reinsurance placements in one place. In certain other developing countries, all foreign reinsurance placements must be shown to the national reinsurance company, which has a right of first refusal. This was the case until recently in Pakistan. In still other countries, as in Ghana, a small percentage of international placements has to be given to the national reinsurance company, so that it is able to scrutinize the terms on which business is being reinsured. Another situation that exists is where there is freedom to place business in the international market (after compulsory cessions to the national reinsurance company have been made), but this can be done only through companies or intermediaries approved or registered by the supervisory authority. This is the case in Egypt. However, proposals for enlistment are sponsored by insurers and the reinsurer in the market, and to this extent there is sufficient flexibility. In Chile, the reinsurers are required to register with the supervisory authority, providing it with full information and a bond in its favour. This measure replaces the earlier situation where the national reinsurer had a monopoly on all reinsurance. In Bangladesh, the private insurance companies have voluntarily decided that they will entrust the Sadharan Bima Corporation with all their international placements, since separately they are too small to obtain satisfactory terms.

Brokers for reinsurance placements

518. When dealing with a single professional reinsurer it may not be necessary to use the services of brokers. Direct dealing may offer many advantages, such as a large capacity, continuity of relationship

and technical advice. However, a company in a developing country may wish to diversify its reinsurance placements and seek quotations from other players in the international market but may not have a sufficient amount of business to cede to several reinsurers concurrently. Thus, intermediation by a broker may become necessary. In addition, independent advice, comparative knowledge of alternatives and of reinsurance programme design are valuable services rendered by brokers.

519. During the last few years, several domestic brokers have started working in developing countries and, although not as prominent as international brokers, many of them have developed expertise and connections beyond their national boundaries. To what extent they are able to provide a satisfactory level of service is a commercial judgement. To improve their expertise domestic brokers should involve themselves with technical aspects of the business, and not rely merely on established international connections to provide these services for them.

C. Developing countries as suppliers of reinsurance

Reinsurance acceptance

520. A distinction can be made between reinsurance accepted in developing countries by the direct insurers and that accepted by domestic reinsurers. Furthermore, we may discriminate between reinsurance emanating from direct markets and that originating from international reinsurance markets.

Direct companies and reinsurance acceptance

521. Direct writing companies accept reinsurance business essentially for two reasons. First, they are seeking to improve their risk spread as their own portfolio may not provide the desired range. An improved spread should produce more stable underwriting results. Secondly, since a substantial amount of the premium is ceded to reinsurers, inward reinsurance is accepted to restore, at least partially, the size of an insurer's operations and bring them in line with the available capacity.

522. Direct insurers accept reinsurance under these two compulsions. When a direct insurer has a reinsurance treaty which has produced a profit over a period of years, opportunities for reciprocal exchange may be negotiated. If the direct insurer's particular insurance line is unprofitable, the opportunity for a mutually satisfactory reinsurance exchange may not exist, and reinsurance will have to be placed non-reciprocally on the best possible terms.

523. The smaller direct insurers in developing countries often have insufficient capital or expertise to write non-proportional international reinsurance business. Profits may emerge over a certain period, but extreme caution is necessary in entering this business.

Brokers for inward business

524. The services of brokers are necessary for negotiating and facilitating inward business. Brokers established in the developing countries can be used since, due to greater familiarity with and closeness to the area, they may be able to arrange a better exchange. Here, the reinsurer, as the seller of reinsurance, will have to pay the broker's commission. To the extent he can identify a developing country insurer with a workable portfolio size, he may make direct arrangements and circumvent the broker and his commission.

Reinsurers of developing countries

525. Developing country reinsurers have come into existence, usually as public enterprises, to meet the aspirations of emerging insurance sectors with regard to retaining a greater portion of the domestic

premium within the country and building up reinsurance expertise. It would appear that, at least in the case of a large number, their capacity remains small. In terms of premium volume, only four reinsurers, namely IRB, Korean Re, ARIG and Egyptian Re, fall into the category of the world's top 100 reinsurers.[16]

526. Even so, a study by Africa Re of 16 reinsurance companies of developing countries reveals that, if judged by an indeed very low norm of net premium of about three times the shareholders' funds[17], the potential capacity of 14 of them seems not to be fully utilized. Using this criterion, Africa Re, for example, would appear to write business equivalent to only 40 per cent of its potential.[18]

Compulsory cessions

527. For most of the reinsurance companies in developing countries, compulsory cessions, often prescribed by law but in certain cases agreed by the market, are the mainstay of their business. Some examples of compulsory cessions are: 10 per cent of fire risks to the Insurance Corporation of Barbados in Barbados; 10 per cent to Caisse Nationale de Réassurance in Cameroon; 30 per cent to Egypt Re in Egypt; 10 per cent to Fiji Reinsurance Corporation in Fiji; 20 per cent to Ghana Re in Ghana; 20 per cent to General Insurance Corporation in India; 25 per cent (and an additional 25 per cent of all treaties) to Kenya Re in Kenya; 10 per cent to Caisse Nationale des Assurances et de Réassurance in Mali; 10 per cent to Société Centrale de Réassurance in Morocco; 20 per cent (and an additional 25 per cent of all treaties) to Nigeria Re in Nigeria; 20 per cent to Pakistan Insurance Corporation in Pakistan; 10 per cent to National Reinsurance Corporation in the Philippines; 15 per cent (fire and marine only) to National Insurance Corporation in Sri Lanka; 5 per cent (except marine hull) to Thai Re in Thailand; and 25 per cent to Milli Re in Turkey.

528. In addition to compulsory cessions to national institutions, some markets also require obligatory cessions to regional reinsurers. For example, companies in member countries are required to give 5 per cent of their treaties to Africa Re. Asian Re obtains, as obligatory cessions from markets of member countries, 5 per cent of the reinsurance business placed abroad or US$ 500,000, whichever is less.

529. It is reported that ZEP Re, a new regional reinsurer set up by the PTA countries in Africa, is to get 10 per cent of treaties from companies in member countries. This move has been strongly contested by the Association of Kenya Insurers (AKI) who view the compulsory cession as a restriction on serving their clients' best interests. The AKI considers ZEP Re to be undercapitalized, as its members have paid in only about 14 per cent of the authorized capital, and is taking legal action to reverse the decision on compulsory cessions.[19]

530. In some markets, although there are no compulsory cessions to a reinsurer, it has been stipulated that a specified percentage of business must be retained in the market. In the Dominican Republic 30 per cent of all reinsurance must be placed with "authorised insurers and reinsurers"; 75 per cent of the capacity should be retained in the local market in Indonesia; and 15 per cent of all business written by foreign companies must be ceded to domestic insurers in Oman. The Nigeria Re in Nigeria has to be given the right of first refusal of all reinsurance business placed outside the country. In Pakistan 35 per cent of all reinsurance has to be offered to Pakistan Insurance Corporation and is designated as an "optional quota".

531. Although data on the profitability of the compulsory cessions received as compared to other business written are not available, it is presumed that, if the direct business is profitable, the compulsory cessions would also produce a reasonable profit. In this connection, periodic reviews and adjustments of commission terms on compulsory cessions given to national and regional reinsurance companies should be considered so that the interests of direct writing companies are safeguarded.

532. An ample part of the business received by reinsurers through compulsory cessions is usually retroceded to the ceding companies, and to this extent reinsurers perform the function of a national pool. Provided the resulting diversification of the direct insurer's portfolio allows a better utilization of his available capacity, retrocessions increase the total retention of the market. However, a few issues have to be kept in mind in the interest of the companies making the compulsory cessions. First, direct writing companies may be required to make obligatory cessions to several organizations - national, subregional and regional reinsurers - and this may have a cascading effect. Secondly, direct insurers should have the option of taking on retrocessions up to the point that they, or the relevant capital and solvency regulations, deem financially viable. Only a limited purpose is served if the reinsurer retrocedes a substantial part of the business to international reinsurance markets. Thirdly, while an overriding commission to cover administration and other expenses is justifiable, it should be modest.

Development of reinsurance companies in developing countries

533. Reinsurance companies that receive compulsory cessions realize that, while such arrangements were necessary in the formative years of their operations, dependence on them has to be scaled down and genuine sources of business developed. Some reinsurance companies, like Tunis Re in Tunisia, are able to operate without any compulsory cessions. In the Republic of Korea compulsory cessions to Korea Re were abolished as from April 1990. It has been proposed, in Turkey, that the compulsory cessions received by Milli Re be phased out over a 10-year period. Apart from the question of reducing compulsory cessions, in recent years it has been contended that it would be fairer to ceding companies to shift gradually from a fixed proportion of total premiums to a share in only the reinsured premiums. The quota share arrangements may have been a simpler method in earlier stages, but it deprives the ceding company of the opportunity of retaining simple risks up to its capacity.

534. In keeping with the trend towards deregulation and liberalization, some changes have taken place in reinsurance markets, particularly in Latin America. In Argentina, Chile and Peru the requirement of routing all reinsurance through the national reinsurer has now been withdrawn. The requirement of retaining all life and 90 per cent of non-life business in the local market in Colombia has also been lifted. In this context it may be noted that Brazil and Argentina cede very little into the international market because, among other things, they have only a small catastrophe exposure. On average, reinsurance cessions from other Latin American countries into the international market amount to about 25 per cent of their total reinsurance portfolio.[20]

535. The task of developing reinsurance business, compulsory cessions aside, is not easy and has its limitations. As in the case of direct writing companies, the capital base of reinsurance companies is, in most cases, small and their capacity is low. If investment income is lacking, the potential for capital growth and increased future retentions is diminished. Even if reinsurance capacity exists with the domestic reinsurer, after having given obligatory cessions, the direct insurers want some diversification and are reluctant to give further business to the national reinsurer. In addition, there is the problem of catastrophic exposure - both man-made and natural - for the reinsurer and too much business from a limited geographical area is not attractive. Furthermore, since such reinsurers are anchored in a country or a region, they cannot stay out of some of the unbalanced and exposed business of the area.

536. Since national and regional reinsurers are a part of the international reinsurance market, they have to take part in international reinsurance business. Unfortunately, the international business available to reinsurers from developing countries may produce losses as well as profit. Further, since each retrocession has commissions deducted at each stage, the profit margin is eroded. The reinsurance companies in developing countries, therefore, have to be extremely careful, selective, and cautious in underwriting inward business. In particular, they should not lend their resources to constitute what has been described in insurance circles as "innocent capacity", or a dumping ground for highly exposed business. At the First Singapore International Reinsurance Conference, held in Singapore in October 1991,

it was pointed out that international reinsurance is a complex and difficult business, requiring substantial capital and reserves, and that reinsurers from developing countries would be better off concentrating on finding niche markets in their own regions by developing certain specializations.

537. Inward business accepted from the international market has often produced losses for reinsurance companies in developing countries. For example, although reinsurance results are best judged over a period of several years, in the Republic of Korea in 1988 the loss ratio on inward business was 116 per cent as against 51 per cent on reinsurance business ceded abroad, and in 1989 the ratios were 107 per cent and 103 per cent respectively.[21] For Egypt Re of Egypt the inward acceptance in 1989 produced a loss ratio of 92.4 per cent, as against 23.5 per cent for reinsurance ceded.[22]

538. During the period under review, certain reinsurers in developing countries have ceased operations. The account of INdeR in Argentina is being run off as a result of a severe financial crisis. Similarly, RMCA (Reinsurance Management Corporation of Asia) in Singapore is also being run off. It has further been reported that Mauritius Re in Mauritius, Philippine Re, Eastern General Re and Reinsurance Corporation of the Orient in the Philippines did not succeed. A substantial volume of retrocession business accepted from international markets is given as a primary reason for their problems. It has been opined that "...many if not all financial failures of third world reinsurers have been caused by underwriting losses from risks accepted from Europe and North America".[23]

Exchange rates and reinsurance

539. The depreciation or devaluation of currencies of developing countries has significance for reinsurance transactions, since reinsurance is usually in the currency of the ceding company (reinsurance on aircraft and oil installations is a notable exception). As sellers of reinsurance, reinsurers in developing countries are in a difficult situation. If the risks reinsured are located in a foreign country, premiums are received and claims have to be paid in that country's currency. If the currency of the reinsurer has depreciated or devalued between receipt of the premium and payment of the claim, a much larger amount in the local currency is required to meet liability. Since the accounts of the reinsurer are kept in local currency, he suffers an "exchange loss".

540. Conversely, when reinsurance is bought in the international market, the reinsurer in the foreign country (usually with a harder currency) may have to pay out a much smaller amount in his own currency for payment of claims to the ceding company, if depreciation or devaluation of his currency has taken place meanwhile. While this may seem to be an additional factor which makes reinsurance emanating from developing countries attractive to the international markets, foreign exchange fluctuations hinder rating based on loss experience alone.

541. Africa Re attributes the decline of gross written premiums by 6 per cent in 1992 to severe depreciations of several members' currencies during the year and mild depreciations in the remaining countries of its participants.[24]

Cooperation amongst reinsurers

542. The benefits of greater cooperation and exchange of business among reinsurers of developing countries have often been emphasized. Numerous subregional and regional pools, as well as the two regional reinsurers, Africa Re and Asian Re, are a practical illustration of such cooperation. A few subregional reinsurance companies have also been established. Mention may be made of CICA Re in the francophone countries of Africa, ZEP Re in the Preferential Trade Area (PTA) for eastern and southern Africa, Arab Re in Arab countries, Arab Union Re in the Syrian Arab Republic and the Libyan Arab Jamahiriya, private sector Nuevo Mundo in Panama and Asean Re in the ASEAN region in Asia.

543. As regards pools, mention may be made of the Africa Aviation Pool and the Africa Oil and Energy Pool managed by Africa Re, the Fire Pool of East Africa managed by Kenya Re, the Africa Fire Pool managed by CICA Re, the Third World Pool managed by Nigeria Re, the WAICA Pool of West Africa, the Pool de Co-réassurance des pays sans littoral established by the West African landlocked countries Burkina Faso, Chad, Mali and Niger, the Organisation of Eastern and Southern Africa Insurers (OESAI) pool, the Arab Fire, Marine and Aviation Pools managed by Arab Re, and the Pool managed by Trin Re in Port of Spain, Trinidad. The Eco Pool, formed between the Islamic Republic of Iran, Pakistan and Turkey is managed by Milli Re. The FAIR Pool is an important interregional pool and is also managed by Milli Re.

544. The Economic Co-operation Organisation (ECO) has decided to convert the Eco Pool into ECO Re, a genuine reinsurance company. A draft constitution is under consideration and a formal agreement is expected to be signed in early 1994.[25]

D. Bilateral reinsurance exchanges

545. Increased bilateral exchange among insurers and reinsurers of developing countries is another way to supplement efforts aimed at increasing premium volume up to full capacity. Business lines of developing countries may often match and have similar characteristics. While bilateral exchanges have not received much attention and support, they are in fact taking place on a substantial scale. It has been estimated that, in Africa alone, the aggregate of bilateral exchanges exceeds the sums involved in formal and institutionalized exchanges.[26]

546. Often, administrative factors and prejudice have hindered the further expansion of bilateral exchange of reinsurance business. Not enough information is exchanged about the characteristics of the markets or the nature of the risks. In this connection it has been pointed out that "we tend to distrust each other to the extent that the average African, Asian or other third world insurance or reinsurance official would prefer to place his business in the international markets rather than with any of his colleagues in the developing markets even where the necessary capacity exists ...".[27] It has been further maintained that "African companies do not seem to be keen to exchange business with each other. When they do, the story goes that African reinsurers are paid last, after all others. So, many have been discouraged from accepting African business altogether in order not to maximize their uncollectible account. Is it not possible to treat each other as other international reinsurers and settle balances in the same manner - not sooner, not later?"[28] Such statements imply that the security perception between reinsurers in some developing countries is at a very low level.

547. In view of the potential for bilateral exchange, three African Reinsurance Exchange Meetings, sponsored by UNDP, UNCTAD and the AIO, were arranged in Cairo, Egypt (1988), Harare, Zimbabwe (1990), and Tunis, Tunisia (1992). Held before the renewal season, their aim was to encourage business among African insurers and reinsurers and to ease somewhat the problems arising from the lack of hard currency. Such exchanges would also improve the spread of risks and ultimately lead to more stable underwriting results.

548. The inability to settle balances with each other because of exchange control regulations is stated to be one of the main hurdles in expansion of exchanges. The AIO and Africa Re have been working on the concept of an African Reinsurance Clearing House, which should provide a mechanism for settling balances. Hard currencies would only be needed for settling the outstanding aggregate.

549. A study undertaken by an AIO subcommittee found that the existing clearing facilities (for example of ECOWAS and the PTA) were not really suitable for insurance and reinsurance transactions. To adjust those mechanisms would required political resolve by the highest authorities of participating countries and possibly involve legislation on their respective modalities. The subcommittee concluded

that this would be a time-consuming and costly exercise whose chances of success would be by no means certain. Thus the implementation of the idea has been suspended for the time being.[29]

550. While a clearing house remains the African industry's ultimate objective, the subcommittee recommended that one should not wait for its realization but should go ahead with bilateral exchanges. It decided that the facilities enjoyed by Africa Re in the matter of transfer of funds from one country to another should be utilized more efficiently to promote exchange of business. For the last few years, Africa Re has already been underwriting an Auto-Fac slip line on behalf of over 40 African companies, and it has been decided to enlarge the scope of this arrangement. At present, the member companies provide a capacity of about US$ 6 million, and with the US$ 1.5 million capacity of Africa Re, a total capacity of US$ 7.5 million is achieved. The business is retroceded to the participating companies after the necessary reinsurance. To this extent the arrangement works as a pool. The premium underwritten has grown to around US$ 4.5 million in the last few years, and the net underwriting surplus has been around 15 per cent of premium underwritten. This surplus ultimately goes to the member companies.

551. At the African Reinsurance Exchange Meeting held in Tunisia in October 1992, it was decided that, with the aim of accelerating bilateral exchange between African professional reinsurers and insurers, an "African Reinsurance Exchange" be constituted, again with Africa Re as the nucleus and the manager. Member companies of the African Insurance Organisation (AIO) will be eligible for membership. Designated shares of treaties and facultative business on risks of the African region will be ceded in priority to cessions outside the continent. The business accepted by the Exchange will be retroceded to members on the basis of the volume of business of their cessions and capacity. Retrocessions received would have to be fully retained for the net account of that member. All participants would make an initial deposit in convertible funds. The Exchange would retain to the credit of each member 25 per cent of the disclosed net surplus (on the basis of a five-year accounting) of the closed year until such time as the amount so retained equals 50 per cent of the member's underwriting capacity in the Exchange. A Technical Committee would supervise various aspects of membership and operations. The agreement has, however, not yet become operational.

552. Since 1987, Maghreb countries had an annual meeting for the exchange of business in the framework of the Rendez-vous de Carthage, which took place around the middle of October. Only Mahgreb countries and brokers participated, and it was reported that this regular event had resulted in an increased exchange of business amongst participating companies. The meeting was discontinued in the aftermath of the Gulf war.

E. Advances made in reinsurance markets of developing countries

553. Certain countries have taken initiatives to establish themselves as reinsurance centres for their region or continent. This applies in particular to Singapore, which is rapidly developing itself as the reinsurance centre of Asia. With 31 reinsurance companies, Singapore has in fact the highest number of reinsurers operating in Asia. Pointing out that Singapore's reinsurers were enjoying good international acceptance, Singapore's Insurance Commissioner has indicated that future plans are aimed at approaching the level of the London market in terms of quality and service. Branch offices are encouraged to upgrade their operations and become locally incorporated. The likely effects of change in 1997 are not clear as yet. Bombay in India is also trying to develop connections with insurers and reinsurers in developing countries. A number of brokers with international infrastructure have emerged. Seoul in the Republic of Korea is also emerging as an important player in the Asian markets.

554. In Africa, Lagos in Nigeria has been establishing itself as a reinsurance centre, hosting the headquarters of four professional reinsurance companies, including Africa Re, and several leading direct insurance companies with international connections. Tunisia is another centre of importance, with Best Re, ARIG and MGFA being in the market, apart from Tunisia Re. Kenya is reported to be developing into

an insurance and reinsurance centre for eastern and central Africa. It hosts the Eastern African Regional Office of the African Reinsurance Corporation, as well as ZEP Re, the reinsurance company established by PTA countries. Some reinsurance companies from developing countries have been establishing representative offices in London and other major locations of interest.

F. Country developments

555. Some of the developments regarding reinsurance in individual countries are described below.

Africa

556. The Preferential Trade Area (PTA) reinsurer ZEP Re has commenced operations on 1 January 1993. The reinsurer was established in November 1992 after the agreement was signed by the member countries. The authorized capital is PTA Units of Account 20 million. ZEP Re has both private sector and parastatal shareholders.[30]

557. In Gabon, in February 1989, a new reinsurance company, the Société Gabonaise de Réassurance (Gabon Re) was founded in Libreville. The leading shareholder is the French Union des Assurances de Paris (UAP), owning 30 per cent of the shares. The Government holds 2 per cent. Other shareholders include reinsurers and insurance companies from France, Germany, the United Kingdom and the United States, and private citizens. Gabon Re will receive a voluntary 20 per cent of all the treaties on the Gabon market, and exchanges will be sought within francophone Africa. Gabon Re has no intention of writing international business in the near future.[31]

558. In Namibia, the Ministry of Finance intends to keep the Namibian insurance market open and competitive. Foreign reinsurers may register or incorporate. It is deemed that the Namibian market is too small to insist on the incorporation of reinsurers, and for this reason a minimum capital requirement has been set for registration of foreign reinsurers to prevent the proliferation of reinsurers in such a small market.[32]

559. In Nigeria, it was reported that companies in the market owe around US$ 25 million to the Nigeria Reinsurance Corporation. Nigeria Re has taken many of them to court and hopes for a prompt settlement. This would enhance the recycling of services to other insurers, as Nigeria Re itself owes considerable amounts to the market as a consequence.[33] Africa Re, Lagos, has reported a decline in gross written premium from US$ 32.8 million in 1991 to 29 million in 1992. However, profits doubled while incurred losses dropped by about 10 per cent and gross loss ratios on fire and accident, and marine and aviation, decreased from 51.13 to 43.3 and 54.16 to 46.91 per cent respectively.[34]

560. In Sierra Leone, the Sierra Leone Reinsurance Co. was to be established by the end of 1991. The objectives are a reduction of the outflow of foreign currency and encouragement of reciprocal exchange of business with international reinsurers.[35]

561. In Zambia, where no professional reinsurer is active, the Zambia State Insurance Corporation (ZSIC) exchanges business with neighbouring reinsurers. In this way efforts are made to contribute to an increase in premium retention on the African continent. Even though the insurance business was liberalized with effect from January 1991, all reinsurance will be handled by ZSIC.[36]

562. The insurance industry in Zimbabwe is reported not to view the establishment of ZEP Re, a regional reinsurance company of PTA member countries, too positively. It opines that since Zimbabwe is the strongest insurance market in the group, it might end up subsidizing the reinsurance markets in other PTA countries.[37]

Asia

563. Asian insurance markets, in particular the Pacific Rim, have been the object of considerable interest on the part of reinsurers in view of their good growth potential. Fire and related property lines remain the predominant classes of business ceded by domestic insurers in South-East Asia, followed by marine cargo and hull insurance. Reinsurance is usually on a proportional basis rather than excess of loss.

564. The placement of proportional business is reported to be evenly split between reinsurance brokers and direct writers, whereas the excess of loss account relies much more heavily on brokers. The countries and territories that have a higher exposure to catastrophes, such as the Philippines and Hong Kong, employ catastrophe excess of loss reinsurance. "On the other hand, where there is little, if any, concern for catastrophe exposure, there is more reliance on proportional treaties and per risk excess of loss covers to protect against large unusual shock losses. This for example is the case in Singapore and Malaysia."[38] The same source also points out that the profitability to reinsurers writing Asian reinsurance business varies by class. Property, marine and motor results emanating from Thailand, Malaysia and Singapore have recently been reported to be profitable. The results from the Philippines and Indonesia have not been so favourable, due in part to several large fire losses.

565. "International reinsurers expect more demand for reinsurance and more sophisticated insurance products and services as the economies of Asian nations develop. Insurance relating to trade will certainly continue to grow as well as liability accounts. The property and related business will require more reinsurance protection particularly for large construction projects which will result in further facultative reinsurance activity and ultimately a growth in treaty protection with large fixed property classes."[39]

566. China, unlike other Asian countries, retains most of its business. In 1989 the gross premium income was approximately US$ 2.1 billion, of which only US$ 70 million was ceded abroad and spread over a very large number of insurance and reinsurance companies.[40]

567. In Fiji, 10 per cent of all risks covered by local companies are ceded to Fiji Reinsurance - a joint venture involving the Government (20 per cent), the local insurance industry (60 per cent) and foreign insurance interests (20 per cent), up to a maximum of F$ 600,000 per individual risk in all insurance classes except aviation. The company, in turn, absorbs up to F$ 250,000 of these risks and obtains excess of loss cover offshore for any additional exposure.[41]

568. In the Republic of Korea, the insurance market has recorded substantial growth in the past decade. Although in April 1990 the compulsory cession system was phased out, international reinsurers did not see their premiums increase quickly, due to the strong role played by the Korean Reinsurance Company and because local capacity must be fully utilized before business can be ceded abroad. But while the amounts ceded from the Republic of Korea have been growing, recent results have been bad for overseas reinsurers, particularly from the catastrophe and per risk excess of loss account, which in 1990 produced several large risk losses, in addition to flood losses resulting from typhoons.[42]

Latin America

569. Reinsurance in the Latin American countries has been decisively marked by privatization and liberalization policies.

570. Developments in Argentina and Brazil in the area of reinsurance are discussed in a separate document on liberalization and privatization.[43]

571. In Colombia, a new circular concerning reinsurance placements abroad stipulates that the office of the Superintendent itself will now authorize such placements. It will no longer act as adviser to the foreign exchange office in this matter.[44] A registration system is to be set up for reinsurers and reinsurance brokers to enable the Superintendent to judge the quality of support obtained by domestic companies. This will imply that foreign insurance and reinsurance companies must have a general agent in Colombia and send their financial statements regularly.[45]

572. In Mexico, a general register of foreign insurers is to be established. Companies are required to be solvent and well established in their country of operation to be included in this register. The Secretary of Finance will continue to maintain a register of foreign insurers of good standing and solvency and with stability in their markets of operation.[46]

573. Peru liberalized its reinsurance market in March 1991. Since then, insurance companies have been free to contract insurance domestically or abroad. The reinsurance should be placed with duly registered national or foreign reinsurance companies (previously, all business relating to domestic reinsurance was to be contracted exclusively through Reaseguradora Peruana). Insurance and reinsurance companies are authorized to form national reinsurance systems. They should, however, disclose all necessary information to the office of the Superintendent. Reinsurance contracts in force in the country or abroad on the date of issue of this legislation could remain in force until the end of the time period of the last policy assigned to those contracts.[47] Meanwhile, Reaseguradora Peruana has been offered for sale.

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Notes

1. Asia Insurance Review, July August 1992, p. 30, Business Insurance, 31 August 1992.

2. Lock, John, "World reinsurance and its future prospects", paper presented at the First Singapore International Reinsurance Conference, Singapore, 1991, p. 4.

3. Coombes, Paul, presentation made at the Monte Carlo Reinsurance Rendezvous, September 1992, Reinsurance Market Report, 22 September 1992, p. 3 and ReActions, October 1992, p. 24.

4. SIGMA, Swiss Re, June 1990, p.9.

5. Greig, John S., quoted in World Insurance Congress, "Signs of upturn in the insurance market," Asia Insurance Review, July-August 1992, p. 30.

6. Peugeot, Patrick, "Don't underrate African business", paper presented at the 14th African Insurance Congress, 1987.

7. World Corporate Insurance Report, No. 124, 13 August 1993, p. 15; Asia Insurance Review, July-August 1993, p. 7.

8. John Lock, op. cit., p. 4.

9. "Reinsurance - London and Third World opinions", Insurance Institute of London, 1981, p. 47.

10. World Insurance Corporate Report, No. 125, 27 August 1993, p. 16.

11. Haag, Herbert N. "How to meet challenges facing the Afro-Asian insurance market", paper presented at the 11th FAIR Conference, Pyongyang, Democratic People's Republic of Korea, 1989, p. 9.

12. Ibid., p. 9.

13. "Reinsurance - London and Third World opinions", op. cit., p. 18.

14. Wijenaike, M. S. "An experiment in regional co-operation", Asia Insurance Review, Special EAIC issue, September 1991, p. 86.

15. Boland, Carol, "Down, but not out", ReActions, September 1992, p. 23.

16. ReActions, September 1992, p. 63.

17. The average net premium to shareholder's funds for the world's top 20 reinsurers gives us a multiple of 0.80 for 1992 and 0.73 for 1991, i.e., much less than the proposed multiple of 3.00 (Business Insurance, 31 August 1992, p. 53, and 30 August 1993, p. 55). Lloyd's uses an even more conservative approach and has a net premium to capital ratio of less than 0.50. Certain continental insurers, in particular those from Germany, may appear to have very liberal ratios of above 4.00. This must not be taken at face value as they are allowed to appraise their assets below market price, often at book value. Price volatility and low liquidity in developing equity, bond and real estate markets, as well as inflationary pressures and currency instability, would suggest a conservative rather than a liberal "net premium to shareholders' funds ratio strategy" for reinsurers in developing countries.

18. Zafu, Eyessus, "The future of national reinsurance institutions in Afro-Asian markets", paper presented at the 12th FAIR Conference, Addis Ababa, 14-15 September 1992.

19. World Insurance Corporate Report, No. 117, 7 May 1993, p. 17.

20. Reinsurance Market Report, 20 October 1992.

21. World Insurance Report, No. 376, 24 November 1989.

22. Olotch, William, "The role of national, sub-regional and regional reinsurance organizations", paper presented at the AIO Conference, Nairobi, Kenya, 1992, pp. 4-5.

23. De Castro, Isagani, "Reinsurance for the nineties", paper presented at the 8th TWIC, New Delhi, 1992, p. 3.

24. World Insurance Corporate Report, No. 125, 27 August 1993, p. 15.

25. The membership of ECO at the time of reporting included Azerbaijan, Turkmenistan, Khazakhstan, Tajikistan, Uzbekistan, Kyrgyzstan, Turkey, Afghanistan, the Islamic Republic of Iran and Pakistan, World Insurance Corporate Report, No. 122, 16 July 1993, p. 15.

26. Aseffa, Yoseph, paper presented at the UNCTAD/AIO Reinsurance Exchange Meeting in Harare, Zimbabwe, October 1990, p. 4.

27. Irukwu, J., "The development of insurance and reinsurance in Afro-Asian countries", paper delivered at the 11th General Meeting of FAIR, Pyongyang, 1989.

28. Aseffa, op. cit., p. 4.

29. Zafu, op. cit.

30. At the time of reporting the member countries were: Angola, Burundi, Djibouti, Kenya, Lesotho, Malawi, Mauritius, Mozambique, Rwanda, Somalia, Sudan, Swaziland, the United Republic of Tanzania, Uganda, Zambia and Zimbabwe. World Insurance Report, No. 449, 6 November 1992, p. 2; World Insurance Corporate Report, No. 115, 9 April 1993, p. 17.

31. World Insurance Corporate Report, No. 13, March 1989, p. 3.

32. World Insurance Report, No. 395, 31 August 1990, p. 4.

33. Insurance Research Letter, August 1990.

34. World Insurance Corporate Report, No. 125, 27 August 1993, p. 15; Reinsurance, September 1993, p. 5.

35. World Insurance Corporate Report, No. 76, 13 September 1991, p. 3.

36. World Insurance Report, No. 403, 18 January 1991, p. 7.

37. Ibid., No. 377, 8 December 1989, p. 7.

38. Piccione, Tal, "The Asian reinsurance markets", paper delivered at the International Insurance Council in New York and published in The Reinsurance Market Report, December 1991.

39. Ibid.

40. Ibid.

41. Best's Review, March 1989, p. 85.

42. World Insurance Report, No. 376, 24 November 1989, p. 6.

43. Insurance in Developing Countries: Privatization of Insurance Companies and Liberalization of Insurance Markets" (UNCTAD/SDD/INS/3/Rev.1).

44. Insurance Research Letter, November 1991.

45. Ibid., October 1991.

46. Ibid., February 1990; ibid., May 1990.

47. Ibid., July 1991.

Chapter XI

COOPERATION AMONG DEVELOPING COUNTRIES IN INSURANCE

A. Introduction

574. A sufficient number of risks, with similar characteristics and a geographical spread, often cannot be obtained within the limitations of a company's business or within the national boundaries of a country. This has lent an international character to insurance and has prompted the establishment of wider formal frameworks of cooperation.

B. Insurance organizations for cooperation

575. The purpose of regional and subregional organizations is to foster an exchange of information among members, to define areas for cooperation, to chart common approaches, and to encourage new contacts. The African Insurance Organisation (AIO) for Africa, the East Asian Insurance Conference (EAIC) for East Asia, the Federacion Interamericana de Empresas de Seguros (FIDES) for Latin America and the General Arab Insurance Federation (GAIF) for Arab countries have launched numerous initiatives leading to greater cooperation. Mechanisms on an interregional basis or involving all developing countries, such as TWIC (Third World Insurance Congress) and FAIR (the Federation of Afro-Asian Insurers and Reinsurers) further widen the scope of regional consultations. TWIC meetings take place alternatively in each developing continent and are attended by a great number of insurers, reinsurers, brokers, and other insurance-related trades from developing as well as developed countries.

576. Regarding cooperation among supervisory authorities, Latin America and Africa both have a regional association of insurance commissioners. The Association of African Supervisory Authorities, established in 1989 during the AIO Conference in Yaoundé, Cameroon, is the most recent cooperative initiative. The subregional association in Asia is the Association of ASEAN Insurance Commissioners. The Association of Insurance Supervisory Authorities of Developing Countries (AISDAC) was established at the second TWIC Congress in Buenos Aires, and is an interregional association for all developing countries. The exchange of information and experiences in insurance legislation, harmonization of legislation, supervision and training were identified as key areas of cooperation by these associations.

577. In 1992, in Washington D.C., a Working Group comprised of representatives from Asia-Pacific, Europe, Latin America, Africa, the Caribbean and North America, was appointed to prepare the ground for the establishment of the International Association of Insurance Supervisors. The objective of the Association is to establish an independent forum for international meetings of insurance supervisors. The Association would promote the awareness of common interests by stimulating liaison and co-operation among supervisory authorities, arranging and facilitating the exchange of views and knowledge, and collating and disseminating technical and statistical information. The Establishment of the Association was formalized in June 1993. Its membership currently numbers 41 countries, of which 17 are developing countries.[1]

578. Reinsurance is an important field for cooperation and developments in this area are reviewed in chapter X. Another potential field of great importance is agricultural insurance and cooperation in this will assist insurers to devise and introduce effective schemes. The New Delhi meeting of TWIC, held in February 1992, resolved that associations, modeled on ALASA (Latin American Agricultural Insurance Association), be formed on a subregional and regional basis to promote agricultural insurance among member countries. ALASA was founded in 1985 as a consequence of recommendations made at the meeting of TWIC held at Casablanca. The AIO and FAIR have also formed standing committees on agricultural insurance.

C. Insurance training institutions

579. In the training of technical and managerial personnel regional institutions may play a pivotal role; institutes such as the Institut International des Assurances, the West African Insurance Institute and the Institut Africain des Assurances in Africa, the Insurance Institute for Asia and the Pacific in Asia, the Instituto Superior Technológico en Seguros in Latin America and the Academy of Insurance for Central America and the Caribbean are pertinent examples of organizations capable of assuming increasing functions. In recent years many national insurance training facilities have been established, mainly devoted to the teaching of basic insurance principles. Active regional cooperation would allow for more sophisticated training activities, which may be beyond the reach of individual developing countries because of their cost and the modest number of persons concerned.

580. Cooperation in respect of training, in particular involving the regional training institutions, has faced serious financing problems. Dependence upon contributions from governments is difficult in a time of increasing public deficits. Managers of insurance concerns have to realize the vital importance of trained personnel for their companies and make efforts to raise the necessary finance.

581. There is a lack of coordination between various training institutes in developing countries. At the Seminar on Human Resources Development in the Field of Insurance, held at Lisbon in 1990,[2] ideas for the establishment of an international network of insurance training institutions were advanced. The main purpose of such a network would be to help disseminate information on curricula and training courses provided by the various centres and offer details on admission possibilities, grants and traineeships for foreign students. The network should also provide training for trainers, give technical assistance and organize regional courses; regional training institutions would play a vital role.

582. At the same time, national training institutes should play a more prominent role in arranging higher-level training on a regional basis. Workshops could be arranged for principal managers from a region with common problems, where case studies are analysed and discussed and where guidance would be provided on how to deal with specific questions. Experience and ideas regarding curricula development could be exchanged, learning material could be swapped, copied and improved. Teachers from developing countries who give courses in a specialty area could lecture at several national institutes in special high-intensity training programmes.

D. Economic integration

583. Two developments in recent years in respect of international cooperation need to be noted. First, the multilateral negotiations under the aegis of GATT, which were concluded in December 1993, included insurance in the negotiations on services.[3] Secondly, the concept of economic integration between countries that "focus on the creation of preferential regional trading arrangements or common markets" has gained momentum.[4] These developments do not conflict. Under the GATT concept of liberalization, countries are free to form preferential regional trading arrangements as long as there is no increase in trade barriers towards countries outside the arrangement. Countries aiming at economic integration may identify four levels of consolidation in increasing strength: a free trade area, a customs union, a common market and an economic union.[5]

584. The concept of economic integration is not new to developing countries. Arrangements such as ALADI, CACM, CARICOM and SECA in Latin America, CEEAC and ECOWAS in Africa, and ASEAN in Asia, to name only a few, have been in existence for a number of years. The successful economic integration of the European Union countries has fuelled new expectations in developing countries. For insurers, economic integration may ultimately lead to increased competition and would enable companies to tap larger markets. Harmonization of laws and regulations is identified as a prerequisite for the efficient functioning of such arrangements in the area of insurance.

585. Recent economic integration arrangements, which have a bearing on insurance markets in a number of developing countries, include NAFTA and MERCOSUR in North and Latin America, PTA and Maghreb countries in Africa and the reinforcement of ASEAN in ASIA. In all of these the insurance sector was included in the negotiations.

Conférence Interafricaine des Marchés d'Assurances (CIMA)

586. The most wide-reaching agreement during the period under review relating specifically to insurance was concluded among the francophone countries of West Africa. Following the recommendations of an Expert Committee constituted in Ouagadougou, in April 1991, a Treaty[6] was signed at Yaoundé, in July 1992. The first Annex to the Treaty establishes the regional organization CIMA (Conférence Interafricaine des Marchés d'Assurances) and defines the objectives as follows:[7]

- To reinforce and strengthen cooperation in the field of insurance so as to enable their markets to cover agricultural risks and those related to trade with policies adapted to African realities;

- To promote the establishment of facilities which will enable insurance and reinsurance concerns of member countries to exchange business in order to increase domestic and regional retention capacities;

- To make appropriate arrangements to enable the local investment of technical and mathematical reserves generated by insurance and reinsurance operations, with due regard to technical requirements such as security, liquidity, diversity and return;

- To continue the common policy of training of executives and technical staff in insurance, for the benefit of the companies and the public administration of member countries;

- To rationalize the management of human resources in companies and administrations by introducing specialization and continuous training;

- To establish common structures in charge of defining and introducing the political orientations and decisions relating to the aforementioned areas with a view to:

  (a) Facilitating the sound and balanced development of insurance companies;

  (b) Promoting the establishment over the entirety of the member countries of an enlarged and integrated market that creates balanced conditions from the technical, economic and financial point of view;

  (c) Introducing new financial instruments to enhance the return on the investments of insurance and reinsurance companies and other institutional investors, including the establishment of financial markets in their respective monetary areas;

- To continue the policy of harmonization and unification of legal and regulatory dispositions relating to insurance and reinsurance operations, supervision of insurance concerns, and to all other objectives that might contribute to the full development of the insurance industry, including management tools and loss prevention measures in the member countries;

- To promote with financial, material and human resources the common institutions which will be established for the promotion of cooperation in insurance and reinsurance matters.

587. To comply with the harmonization and unification requirements mentioned above, the Conference adopted a unified code of legislation and established a common supervisory body for insurance, thereby harmonising the methods of national insurance supervision. The Treaty establishes an integrated insurance industry in the African States of Benin, Burkina Faso, Cameroon, the Central African Republic, Chad, Congo, Côte d'Ivoire, Gabon, Mali, Niger, Senegal and Togo (with two other countries to adhere later on). The Treaty will come into effect when ratified by at least seven of the signatories. It was reported that 31 December 1993 was set as the target date for full implementation.[8]

588. While the advantages of such a Treaty are obvious, African insurers have voiced concern that this may allow foreign insurance companies to have access to various African markets by establishing a subsidiary in any one of the member countries. It has been agreed that a foreign insurer would need the specific consent of the country (or countries) concerned in order to operate in countries other than where the insurer has been authorized to do so.

589. In November 1991, the above countries enacted a new African Insurance Code and established a common scale for the indemnification of traffic accident victims. Motor tariffs were liberalized, each company establishing its own motor rates, with maxima and minima to be declared to the supervisory body. The harmonization of the Brown Card (see chapter IV on motor insurance) was also studied.

Maghreb countries

590. The Maghreb countries, namely Algeria, the Libyan Arab Jamahiriya, Morocco and Tunisia, have entered into negotiations for the harmonization of legislation, cooperation among companies in the region and the creation of a regional organization of companies. One of the first regional achievements was the pooling of aviation risks for common placement in the international market, resulting in a substantial reduction in insurance costs for the national carriers of the negotiating countries.

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Notes

1. The supervisory authorities of the following developing countries are members of the International Association of Insurance Supervisors: the Bahamas, Brazil, Colombia, Egypt, Ethiopia, Fiji, Ghana, Malawi, Malaysia, Malta, the Philippines, Solomon Islands, Thailand, Tunisia, Turkey and Uganda.

2. See endnote 30. from chapter I, para. 34.

3. "GATT Activities" - GATT/1991-2.

4. UNCTAD, "Review of the economic integration experience of ALADI, ASEAN, CACM and ECOWAS" (UNCTAD/ECDC/217).

5. Ibid.

6. Traité instituant une organisation integrée de l'industrie des assurances dans les Etats africains, Yaoundé, 10 July 1992.

7. Marchés Tropicaux, 30 July 1993, p. 2000.

8. World Insurance Report, No. 444, 28 August 1992, p. 5; ibid., No. 437, 22 May 1992, p. 4.